

VERMONT STATE EMPLOYEES' RETIREMENT SYSTEM

Meeting of the Board of Trustees

May 20, 2004

Members present:

WARREN WHITNEY, Chairperson, VSEA member (term expiring September, 2004)

ROBERT HOOPER, VSEA member (term expiring September 2004) – **later in the meeting
via conference call**

WILLIAM HARKNESS, VSEA member (term expiring September 2005) – **arrived later in the meeting**

JEB SPAULDING, Vice-Chairperson, VT State Treasurer

CINDY LAWARE, Commissioner of Personnel – **arrived later in the meeting**

ROB HOFMANN, Commissioner of Finance & Management

DICK JOHANNESSEN, Governor's Delegate

GORDON MACARTHUR, Retired Vermont State Employees' Association

CATHERINE SIMPSON, VSEA Alternate (term expiring September 2005)

Also attending:

Cynthia Webster, Director of Retirement Operations

David Minot, Director of Investment Services

Dick Charlton, Ellen Griggs, Kevin Kondry, NEPC

Elizabeth Pearce, Deputy VT State Treasurer

Investment Manager personnel

The Chairperson, Warren Whitney, called the board meeting to order at 8:16 a.m. on Thursday, May 20, 2004 in the Department of Employment & Training Conference Room at 5 Green Mountain Drive, Montpelier, VT.

ITEM 1: Approval of minutes for May 13, 2004

On a motion by Mr. Johannesen seconded by Mr. Spaulding, the Board unanimously voted to approve the minutes of May 13, 2004, as submitted.

ITEM 2: Investment Consultant Report for Q1/04

Ms. Griggs advised the Board as a result of the Board's action to terminate Henderson Real Estate, the refund of approximately \$38 million is expected by June 1st. Because of the nature of the asset class and the remaining manager's income cue, the transfer of the additional allocation to UBS Realty cannot happen for several months, perhaps by March 2005, at the earliest. Ms. Griggs outlined options for placement of the \$38 million during the interim

Ms. LaWare arrived at the meeting during the performance summary discussion.

Mr. Charlton, Mr. Kondry and Ms. Griggs reviewed the first quarter 2004 performance. They reported the market value of the fund balance at approximately \$1.044 billion and a quarterly return of 2.8%, an under performance of the 2.9% median public fund. The one-year return was 28.6% vs. the median public fund at 26.9%, three-year return 5.9% vs. the median public fund at 5.5% and a five-year return of 4.4% vs. 4.8%.

The Board discussed and agreed they would like to participate in an NEPC joint education presentation (for the three systems) regarding alternative investments. NEPC will also prepare an educational presentation of restructure and/or options regarding large cap passive, enhanced, or active management, management fee structures and history, etc.

Mr. Minot advised that North Atlantic Investments II, the primary alternative investment manager, would be making a distribution to the system effective today.

▪ **Review Investment Policy Guidelines as updated by NEPC**

NEPC will distribute the Policy Guidelines to the system's managers and they are also available on the Treasurer's web site.

Mr. Spaulding left the meeting.

Mr. Hofmann left the meeting.

Mr. Harkness arrived at the meeting.

ITEM 3: Investment Manager Presentations

UBS Global Asset Management – Global Equity: Steve Wilde, Executive Director & Client Services and Bruno Bertocci, Executive Director & Global Equity Portfolio Manager appeared before the Board. As of March 31, 2004 the portfolio market value was approximately \$87.5 million with a first quarter 2004 return of 2.9% compared to the CITI EPAC index of 4.4%; 1-year performance was 51.0% vs. 57.9%; three-year performance was 6.2% vs. 3.9% and five-year performance was 3.5% vs. 1.1%.

Mr. Charlton and Ms. Griggs advised the Board of the pending separation of the Delaware Investments International Equity team who have chosen a management buyout option of the London-based International Equity investment management unit from the parent company Lincoln International to Atlantic Value Partners Ltd, a newly formed company associated with certain members of Hellman & Friedman LLC, a US private equity firm. They will remain managers of the Global mandates, through assignment of the portfolio contracts by the new parent organization. Ms. Griggs also advised the Board of Delaware's recruitment of an entire four-person Large Cap Value portfolio management team from Merrill Lynch approximately two months ago. The new team possesses a separate and distinct (deeper value, slightly riskier) style, and offers another investment component to the firm.

Mr. Spaulding returned to the meeting during the next presentation.

Delaware Investment Advisors – Domestic Large Cap Equity Value: Ged Deming, Senior VP & Sr. Portfolio Manager and Dave Prince, Senior VP of Client Services appeared before the Board. As of March 31, 2004 the portfolio market value was approximately \$102.3 million with a first quarter 2004 return of 1.7% compared to the Russell 1000 Value index of 3.0%; 1-year performance was

39.4% vs. 40.8%; three-year performance was 4.3% vs. 4.3% and five-year performance was 4.3% vs. 3.9%.

Mr. Prince also shared the recent changes in the organization's structure.

Rothschild Asset Management – Small Cap Value Equity: T. Radey Johnson, CEO and Small/Mid Cap team leader, appeared before the Board. As of March 31, 2004 the portfolio market value was approximately \$67.4 million with a first quarter 2004 return of 6.2% compared to the Russell 2500 Value index of 6.2%; 1-year performance was 43.7% vs. 61.6%; three-year performance was 17.1% vs. 15.8% and five-year performance was 16.4% vs. 15.2%.

Mr. Johnson explained that the original mandate effective June 1998 was a small cap value product with the Wilshire Small Cap Value Index, however the assigned Russell 2500 Value Index in July 2001 permits expansion into the current product of a small/mid cap mix. Mr. Johnson stated he would forward information to Mr. Minot regarding the change.

ITEM 4: Director of Retirement Operations Report

A. Retirement Legislative Update

Ms. Webster reported that a list of housekeeping items from the three retirement systems was originally drafted into a House Government Operations committee bill. The items are now included in bill S-206, which contains the mandate for a 5-year membership to qualify for a retirement benefit, and therefore access to an 80% health insurance premium benefit from the system, and an amendment that adds the word *designated* dependent beneficiary for active death-in-service survivorship benefits. An additional housekeeping item to clarify the \$5K life insurance payment to employees with twenty or more years of service, and clarification of amortization of the unfunded liability for the plan are included.

Ms. Webster explained because of several controversial issues and input by lobbyists and union representatives the requirement of ten-year service requirement to be entitled to continue health insurance benefit with 80% of the premium paid by the state was trimmed from the original amendments.

Further reported was the commitment by the Retirement Office and other interested parties to study the three retirement systems over the next few months and draft a unified presentation for amendments to next year's legislature.

B. Deferred Comp Reserve Fund

Ms. Webster explained that members of the Treasurer's Office staff have examined the 457-reserve fund and once unpaid liabilities were recognized the actual balance of the reserve fund was found to be approximately \$177K. She said that \$148K of that balance is the result of a deposit by the prior third-party administrator for an agreed upon rebate of 12-B1 fees. Also reported was that the 25 basis points currently paid by participants is nearly the exact amount needed to pay the quarterly third-party expenses, therefore no changes in participant fees are currently recommended.

C. Emergency 457 Plan Withdrawal

On a motion by Mr. Spaulding seconded by Ms. LaWare, the Board unanimously voted to approve the recommendation of Great-West Retirement Services for the emergency withdrawal for Mary Lynn Reid.

ITEM 5: Any other investment related business to come before the Board

Ms. Simpson provided a brief summary of her recent attendance at the NCPERS annual conference.

Mr. Johannesen advised that he would be attending the June 2-3, 2004 NEPC conference. Mr. Whitney asked for other interested members to contact him.

Mr. Hooper joined the meeting via conference call.

Ms. Simpson stepped down.

ITEM 6: Director of Finance & Investments Report

A. Timber Funds

Joyce Niggley of Wachovia Balance Timberland Fund appeared before the Board and reported the sale of the firm to Regions Morgan Keegan Bank and the company is now known as RMK Timberland Group.

As of March 31, 2004 the portfolio market value was approximately \$8.128 million with a first quarter 2004 return of 1.4% and since inception (8.63 years) return of 8.43%.

The Board requested that Mr. Minot, the AG's Office and NEPC review the existing contract prior to signature of the advisory agreement presented by RMK Timberlands Group.

On a motion by Ms. LaWare seconded by Ms. Simpson, the Board unanimously voted to forward the original manager contract and authorization notice to assign the contractual rights, title and interest in the investment advisory agreement between Wachovia Balance Timberland Fund and VSERS to Regions Morgan Keegan, to the Attorney General's office and NEPC for review and recommendation at the July conference call meeting.

B. Real Estate Investment Update

Ms. Griggs reviewed her earlier comments regarding the lag in ability to reinvest the \$38 million refund from Henderson Real Estate as an additional allocation at UBS Realty.

The Board discussed the options of 1.) placing the funds in an REIT account with Morgan Stanley Prime Property fund along with the Teachers' Retirement System, 2.) request a partials liquidation from Henderson Real Estate, or 3.) do a manager search.

On a motion by Mr. Johannesen seconded by Ms. LaWare, the Board voted to authorize NEPC to initiate a manager search for a new real estate manager. Mr. Spaulding, Mr. Whitney, Mr. Harkness, Ms. Laware, Mr. Hooper and Mr. Johannesen voted yes. Mr. MacArthur abstained.

ITEM 7: Treasurer's Report

A. Unitization Update

The Treasurer advised the Board the unitization bill did not pass this year, however, it is possible that the individual retirement systems, with Board approval, could unitize assets on their own and without legislation. Mr. Spaulding is awaiting an opinion to confirm that option from the Attorney General's Office.

Mr. Hooper left the meeting.

Ms. Simpson assumed a voting member position.

B. Retirement Office Consultant Recommendations

Ms. Pearce distributed and reviewed the results of the Maximus report and Executive Summary.

The recommendation is to restructure the Retirement Office into three groups of services; employer services, member services and accounting. The majority of the employees would perform duties in the member services area, with two employees dedicated to the employer services and two employees dedicated to the accounting sections. Extensive cross training of job functions will improve customer service.

The Board was also advised of movement to an automated telephone system and plans for improvements in the technology area that will be implemented including imaging, employer reporting, and a new computer system.

Next Meeting Dates:

The next scheduled conference call meeting is June 10, 2004.

The next scheduled quarterly investment meeting is August 19, 2004.

Mr. Whitney advised the Board of the Green Mountain Summit in Stowe this weekend. If attending, please notify the Treasurer.

On a motion by Mr. Spaulding seconded by Ms. LaWare, the Board unanimously voted to adjourn at 2:30 p.m.

Respectfully submitted,

Cynthia L. Webster , Executive Secretary to the Board

GOALS

The Board established the following list of goals to be addressed in the future:

- Form a *Policy Development* sub-committee

BOARD FOLLOW-UP ITEMS

<u>Who</u>	<u>What</u>	<u>When</u>	<u>Done</u>
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** = for possible 2004 legislative changes